

BLUE MODEL CRISIS

Another City Eyes Chapter Nine

Even as the stock market booms, many American cities are watching their financial situations deteriorate as they struggle to cover explosive pension obligations for retired civil servants. Chicago is in dire straits, with analysts weighing the possibility of bankruptcy for the public school system. Meanwhile, in Hartford, Connecticut—another major city in a wealthy blue state—there are also rumblings of Chapter Nine. *Bloomberg reports:*

Like many other local governments across the country, Hartford — city of Mark Twain and the young John Pierpont Morgan — has been grappling with budget problems for years. On the same day that Illinois lawmakers finally scraped together a long-overdue budget, Hartford hired the law firm Greenberg Traurig LLP to evaluate its options, which include bankruptcy. It would be the first prominent U.S. municipality to seek protection from its creditors since Detroit did so in 2013.

As the article notes, Connecticut is in trouble in part because the hedge fund industry, one of its major sources of economic activity, has contracted in recent years, cutting into the state's tax revenue even as it has to pay growing pension bills. This is a higher-end version of the problem that forced Detroit into bankruptcy: As the manufacturing industry faded, the Motor City could no longer afford defined-benefit pensions that depended on a constantly growing economic base. Both cities would have been better off with 401(k)-style pension plans, whereby workers saved for their own retirement and the city wasn't stuck paying a guaranteed income to thousands of retirees even as its economic base shrank. Defined-benefit pensions made sense when we expected companies and industries to stick around for long periods of time; but at a time of economic transition, they can bankrupt local governments in the blink of an eye.

More broadly, Hartford's struggles highlight the severity of the crisis of public finance for states and localities across the United States. The fact that states like California, Illinois and Connecticut—home to dynamic economies and enormous reserves of wealth—are struggling mightily to fund their pension obligations even in the midst of a long bull market suggests that there are major structural problems below the surface. They are likely to be exposed in the next recession.

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